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SURVEY CASTS DOUBT ON GREENFIELD RISK PREMIA

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Asia
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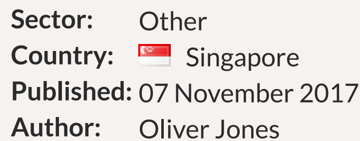
Country: Singapore
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Author: Oliver Jones

The latest Investor Perceptions of Infrastructure 2017 survey finds that investors do not require a greater risk premium to invest in greenfield projects compared to brownfield ones.

The survey of 186 investors representing USD 7trn assets under management was undertaken by the Global Infrastructure Hub and EDHEC Infrastructure Institute-Singapore.

EDHECinfra director Frederic Blanc-Brude said "it's good news – there is no reason to require a greenfield premium as long as investors can invest across the board," since greenfield risk is diversifiable.

The same survey last year found a greenfield risk premium. Blanc-Brude put this down to how the question was framed, with this year's survey moving away from asking investors directly whether they required a risk premium to invest in greenfield assets.

Instead, it asked respondents to express their views about detailed investment propositions and required returns on an investment-by-investment basis, mixing greenfield and brownfield opportunities.

The result was that the construction risk premium is on average zero. Still, Blanc-Brude acknowledged a wide range of return expectations among investors – the result is for a representative investor.

If an asset owner invests directly in one greenfield project a year, for example, then the fact that construction risk is diversifiable may be of little comfort, Blanc-Brude acknowledged.

The results suggest that investors in funds targeting greenfield projects should not expect to earn a risk premium.

Blanc-Brude observed that investors and banks can offload construction risk to construction companies, which agree to fixed price contracts because they can diversify away idiosyncratic construction risk.

The survey found that 37.5% of asset owners are invested in emerging market infrastructure, up from 20% last year. Further, of those already investing in emerging markets, 81.8% want to increase their exposure. A huge 85% of respondents expect the pipeline of projects in emerging markets to grow over the next few years. In contrast, 65.5% expect the future infrastructure pipeline in OECD markets to shrink or remain stable, compared to the past 3-5 years.

Overall, the required return on equity for investments in OECD infrastructure was 10.6-12.3% compared to 16.9-19.6% for emerging markets, giving an average emerging market risk premium of at least 6.3%.

But the premium demanded to invest in merchant infrastructure was 150 basis points for both emerging markets and OECD countries – or 12.2-13.8% for OECD countries and 18.2-21.3% for emerging markets.

In contrast, regulated infrastructure carried a higher risk premium in emerging markets – with returns of 18.7-23.9% required for regulated infrastructure in emerging markets compared to 11.4-12.6% in OECD countries. Likewise, contracted infrastructure (such as PPPs) required returns of 16-17.5% in emerging markets compared to 10.3-12.3% in OECD countries.

Blanc-Brude observed that “merchant risk is a bet on economic growth – it’s the same bet anywhere,” with the same risk premium for OECD countries and emerging markets also being revealed in last year’s survey.

He added that the situation is the reverse for contracted infrastructure in emerging markets, because investors “don’t believe that things aren’t going to change in 10-15 years’ time”.

“Brownfield, contracted infrastructure is [relatively] riskier in emerging markets because there are more uncontrollable factors,” he added. Still, he acknowledged that the early stage that most institutional investors in Asia are at when it comes to investing in infrastructure suggested more demand for brownfield assets, as investors go through a learning process, investing “first in brownfield utilities”.

The Singapore-based research institute – which is part of a French business school – released infrastructure debt and equity indices covering 14 European markets in June this year.

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